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Docket #(s): T-01072A-13-0412

Arizona Corporation Commission

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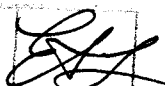
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Exhibit #: A-1, A-2, S-1

Exhibit A-1

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH



IN THE MATTER OF THE APPLICATION OF
SOUTHWESTERN TELEPHONE COMPANY,
AN ARIZONA CORPORATION, FOR A
HEARING TO DETERMINE THE EARNINGS
OF THE COMPANY, THE FAIR VALUE OF
THE COMPANY FOR RATEMAKING
PURPOSES, AND TO INCREASE
RESIDENTIAL RATES AS NECESSARY TO
COMPENSATE FOR THE RATE IMPACTS OF
THE FCC'S USF/ICC TRANSFORMATION
ORDER

DOCKET NO. T-01072B-13-0412

APPLICATION

1 Southwestern Telephone Company ("Southwestern Telephone"), an Arizona corporation,
2 hereby applies pursuant to A.R.S. § 40-250 and the Commission's Rule R 14-2-103 for a
3 determination of Southwestern Telephone's earnings and the fair value of its investment and
4 requests that its residential rates be increased as necessary to compensate for the rate impacts of
5 the Federal Communication Commission's November 18, 2011, USF/ICC Transformation Order
6 ("USF/ICC Order").

7 **I. BACKGROUND**

8 On November 18, 2011, the Federal Communications Commission issued the USF/ICC
9 Order. The USF/ICC Order transitions the outdated federal universal service programs and most
10 inter-carrier compensation systems into a new Connect America Fund ("CAF"). The FCC's
11 press release characterized the USF/ICC Order as "the most significant policy step ever taken to
12 connect all Americans to broadband."

1 The USF/ICC Order will reduce inter-carrier compensation rates to zero by July 1, 2020,
2 for rate of return companies, with limited recovery from customers and partial recovery from the
3 CAF. The recovery from the CAF will phase out over time at 5% annually.

4 Southwestern Telephone is a small rate-of-return regulated Incumbent Local Exchange
5 Carrier ("ILEC"). Of particular importance to Southwestern Telephone and other rural ILECs,
6 the USF/ICC Order adds new rules that will reduce federal high-cost loop support to carriers by
7 the amount their flat-rate residential local service rates fall below a specified annual urban rate
8 floor.¹ The rate floor includes, if any, state subscriber line charges, state universal service fees,
9 and mandatory extended area service charges. The FCC's order established local residential rate
10 floors of \$10.00 as of June 1, 2012, and \$14.00 as of June 1, 2013, with the floor thereafter being
11 determined annually by the FCC's Wireline Competition Bureau, based on a nationwide
12 average.²

13 The Wireline Competition Bureau has not yet determined the rate floor to be in effect for
14 June 1, 2014. The nationwide residential average rate was \$15.62 in 2008. Estimates for the
15 2013 nationwide residential average rate range from \$17.00 to \$18.50, so the 2014 rate floor will
16 certainly be substantially higher than 2013's \$14.00 rate floor.

17 Federal and state support funding are vital to a robust telecommunications network in
18 high cost areas. To maintain federal loop support, Southwestern Telephone and other rural
19 ILECs must increase local rates to the FCC-mandated residential rate floors. Otherwise, the
20 amount of federal support funds will be reduced dollar-for-dollar for each customer by the
21 difference between the existing local rate and the new rate floor. If local rates are not increased,
22 the new FCC rules will reduce funds coming to the state of Arizona and negatively impact
23 customers living in high-cost areas in the state.

¹ 41 C.F.R. § 54.318.

² USF/ICC Order paragraph 236 states the most recently available nationwide average local rate from 2008 was \$15.62.

1 Low customer density makes Southwestern Telephone dependent on high-cost federal
2 support mechanisms. It is important that the company be allowed to increase local rates to the
3 FCC determined annual rate floors in order to maintain its existing federal support.

4 The Wireline Competition Bureau is not expected to set the 2014 rate floor until the end
5 of this quarter or the first quarter of 2014. If the rate floor is not set until 2014, it could be
6 difficult for the Commission to timely review an application and authorize new rates for
7 Southwestern Telephone by June 1, 2014. This would cause Southwestern Telephone to lose
8 federal high-cost loop support dollar-for-dollar by the amount the new rate floor exceeds current
9 \$14 residential rates.

10 To prevent the loss of federal support, Southwestern Telephone requests that the
11 Commission approve a local residential rate increase of up to \$19.00. The actual rate
12 implemented would be set at the lower of the approved 2014 residential rate floor and \$19.00.
13 Southwestern Telephone will file the new FCC rate floor as soon as it is available.

14 **II. SOUTHWESTERN TELEPHONE**

15 Southwestern Telephone Company is a corporation duly organized and existing under
16 and by virtue of the laws of the State of Arizona. Southwestern Telephone is authorized to
17 engage in and is now engaged in the conduct of a general communications business within the
18 State of Arizona.

19 **III. SUMMARY OF REQUEST**

20 This application is made pursuant to the provisions of A.R.S. §§ 40-250 and 40-367, and
21 Commission Rule R14-2-103. The Commission last considered Southwestern Telephone's rates
22 in Docket No. T-01072A-12-0472, which resulted in Commission Decision 73874 issued on
23 May 8, 2013. Decision No. 73874 authorized Southwestern Telephone to raise its residential
24 one-party rates to \$14.00/month, effective June 1, 2013. As discussed above, these rates are
25 substantially below the expected federal rate floor that will go into effect on June 1, 2014.

26 Southwestern Telephone is aware that many parties, including the Commission, have
27 appealed the USF/ICC Order. However, in the meantime, Southwestern Telephone and other

1 rural ILECS must comply with all provisions of the USF/ICC Order and will remain subject to
2 the increased local residential rate floors and the corresponding losses of federal support funds.

3 Southwestern Telephone's loss of federal support funds would be particularly difficult to
4 bear. As the attached schedules demonstrate, Southwestern Telephone's return on investment is
5 negative at current rates. Put another way, Southwestern Telephone's jurisdictional earnings are
6 negative. Losing federal support funds will only drive earnings deeper into the red.

7 In connection with this application, Southwestern Telephone has filed exhibits which
8 include a schedule of the specific rate changes requested and the impact of the revenue generated
9 on the company's financial position. Southwestern Telephone asks that the Commission
10 determine the fair value of the company's investments for ratemaking purposes and stipulates to
11 use original cost less depreciation for those purposes. Because the next opportunity to affect
12 federal support funds is June 1, 2014, Southwestern Telephone further asks that the Commission
13 approve a local residential rate of up to \$19.00. At \$19.00, Southwestern Telephone's return on
14 rate base would only be 1.0%. The actual rate implemented would be set at the lower of the
15 approved 2014 residential rate floor and \$19.00, so the actual return on rate base would be less
16 than or equal to 1.0%. Southwestern Telephone asks that the customer notice issued by the
17 Hearing Division inform customers of this potential range of rate increases.

18 To facilitate processing of this application, Southwestern Telephone also asks that the
19 Commission waive any provisions of Commission Rule R14-2-103 not required by the Arizona
20 Constitution and laws.

1 Respectfully submitted on November 27, 2013.

2
3
4 /s/Craig A. Marks

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12 Attorney for Southwestern Telephone Company

Original and 13 copies filed
on November 27, 2013, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

By: /s/Craig A. Marks
Craig A. Marks

Southwestern Telephone Company

Streamlined filing to support residential rate increase due to FCC
floor implementation and resulting HCL loss.

November 15, 2013

Southwestern Telephone Company

November 15, 2013

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Southwestern Telephone Company

November 15, 2013

REGULATED RESULTS OF OPERATIONS FOR TWELVE MONTHS ENDING JUNE 30, 2013
REFLECTS CHANGES EFFECTIVE WITH ARC AND CAP IMPLEMENTATION - YEAR 2

	TOTAL TELEPHONE OPERATIONS (a)	ADJUSTMENTS (b)	Ref (c)	ADJUSTED RESULTS (d)	INTERSTATE RESULTS (e)	INTRASTATE RESULTS (f)
1 Local	695,697	-1,563 #7		695,034	0	695,034
2 Universal Service Fund (USF-HCL)	453,594	-57,851 #5,6		385,743	0	385,743
3 Access Revenues	1,680,585	-31,829 #6,7	#1,2,3,	1,648,756	1,158,381	490,375
4 Billing & Collecting	30,135	-78 #8		30,057	12,474	17,583
5 Other Misc., Uncollectibles	81,523			81,523	31,364	50,159
6 Total Operating Revenues	2,942,534	-101,421		2,841,113	1,202,219	1,638,894
7 Plant Specific Expenses	592,733	41,420 #10		634,153	269,114	365,039
8 Plant Non-specific Expenses	260,364	16,969 #7,10		277,333	147,828	129,505
9 Depreciation & Amortization Expenses	933,069	96,223 #10		1,029,292	415,777	613,515
10 Customer Operations Expenses	307,124	14,169 #9,10		321,293	111,003	210,290
11 Corporate Operations Expenses	398,991	22,242 #10		421,233	143,731	277,502
12 Other Operating Taxes and (Income)	54,167	112,255 #9,10		166,422	72,011	94,411
13 Nonregulated Adjustment (Part 69 WBI)		-280,597 #10		-280,597	-280,597	0
14 Total Operating Expenses	2,546,448	12,881		2,559,329	868,867	1,690,462
15 OPERATING RETURN BEFORE TAXES	396,086	-114,102		281,984	333,352	-51,368
16 State Income Taxes (SIT) (6.97%)	25,919	-7,265 #11		18,654	23,235	-3,580
17 Federal Income Taxes (FIT) (35%)	130,482	-38,667 #11		91,815	108,541	-16,726
18 Total Operating Income Taxes	157,401	-45,931		111,470	131,776	-20,306
19 Total Expenses and Income Taxes	2,703,849	-33,250		2,670,599	1,000,643	1,669,956
20 Net Operating Income	238,685	-68,171		170,514	201,576	-31,062
21 Total Year-End Rate Base	3,504,514	0		3,504,514	1,366,096	2,138,418
22 Return on Rate Base (Ln 20 / Ln 21)						-1.5%
23 Estimated Revenue from Local Rate Increase						87,360
24 State Income Taxes (SIT) (6.97%)						6,089
25 Federal Income Taxes (FIT) (35%)						28,445
26 Increase in Net Operating Income						52,826
27 Net Operating Income After Increase (Ln 20 + Ln 26)						21,764
28 Return on Rate Base After Increase (Ln27 / Ln21)						1.0%

ASSUMPTIONS

Used 2012 Cost Study run dated 07/18/2013 for Part 36 separation of expenses.
Separated results based upon frozen 2000 traffic factors
Separated results based upon 6/30/2013 financials, interstate rules, adjusted for Part 64 activities
Working Capital included for all jurisdictions

Southwestern Telephone Company
Adjustments to Revenues and Expenses

Ref	Account	Description	Debit	Credit
1.	5082200	Access Revenues		817
	5083000	Access Revenues		196
	Exclude		1,013	
	To remove prior period (2009) interstate revenue requirement adj.			
2.	5082200	Access Revenues	642	
	5083000	Access Revenues	144	
	Exclude			786
	To remove prior period (2010) interstate revenue requirement adj.			
3.	5082100	Access Revenues	12,219	
	5082200	Access Revenues		12,546
	5083000	Access Revenues	3,721	
	Exclude			3,394
	To remove prior period (2011) interstate cost study true-up.			
4.	5082200	Access Revenues		5,614
	5083000	Access Revenues		2,275
	Exclude		7,889	
	To remove prior period (2011) interstate revenue requirement adj.			
5.	5082110	Universal Service Fund	64,317	
	K&M			64,317
	To adjust for Federal HCL projected change for 2013.			
6.	5082110	Universal Service Fund	3,534	
	5082100	Access Revenues		183
	5082200	Access Revenues		558
	PPA			2,793
	To remove prior period HCL/LSS/ICLS revenues.			
7.	5001000	Local Revenues	1,663	
	5082200	Access Revenues	14,282	
	5084220	Access Revenues	23,010	
	6540010	Plant Nonspecific Exp		655
	Exclude			38,300
	Year 2 FCC Order ICC intrastate and interstate revenue and expense reductions.			
8.	5270100	Interstate B&C	78	
	PPA			78
	To remove prior period adjustment.			

Southwestern Telephone Company
Adjustments to Revenues and Expenses

Ref	Account	Description	Debit	Credit
9.	6623304	Customer Operations Exp		22
	7240200	Other Operating Taxes	568	
	7240300	Other Operating Taxes	49	
	7240900	Other Operating Taxes	12,741	
	PPA			13,336
	To remove prior period adjustments.			
10.	6112004	Plant Specific Exp	1,350	
	6121004	Plant Specific Exp	9,409	
	6232004	Plant Specific Exp	24,892	
	6423004	Plant Specific Exp	5,769	
	6532004	Plant Nonspecific Exp	17,624	
	6561000	Depreciation Exp	96,223	
	6611004	Customer Operations Exp	11,752	
	6623304	Customer Operations Exp	2,439	
	6728904	Corporate Operations Exp	22,242	
	7130000	Other Operating Income	94,113	
	7240900	Other Operating Taxes	4,784	
	7990000	Nonregulated Exp		290,597
	To reverse transfer of estimated Part 69 interstate expenses for WBI (Internet) to enable proper Part 36 allocation of total company expenses.			
11.	7220000	Federal Income Tax		38,667
	7230020	State Income Tax		7,265
	PPA		45,931	
	Adjust income taxes to remove prior period amounts and for adjustments to results.			

Southwestern Telephone Company

Base Line of Eligible Recovery:

	Total	Reduction	
Interstate SWA (Includes LSS)	300,681	(14,282)	Interstate
Intrastate Terminating Access	475,081	(23,010)	Access Revenue
Recip Comp Revenue	35,016	(1,663)	Access Revenue
Recip Comp Expense	(13,789)	655	Local Revenue
Total Base of Eligible Recovery	796,989	(38,300)	Plant Non-Specific
			Intrastate Local
			Intrastate Local
			AJE #7

Southwestern Telephone Company

Rate Base

As June 30, 2013

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 18,462,869	\$ 7,892,320	\$ 10,570,549
Accumulated Depreciation	(14,544,450)	(6,324,721)	(8,219,729)
Net Plant in Service	\$ 3,918,419	\$ 1,567,599	\$ 2,350,820
Plant Under Construction	20,587	8,757	11,830
Material & Supplies	118,826	34,484	84,342
Deferred Income Taxes	(690,039)	(293,463)	(396,576)
Cash Working Capital	136,721	48,719	88,002
Rate Base	<u>\$ 3,504,514</u>	<u>\$ 1,366,096</u>	<u>\$ 2,138,418</u>

Southwestern Telephone Company
For Twelve Ending June 30, 2013

CALCULATION OF CASH WORKING CAPITAL (CWC)

CASH OPERATING EXPENSES	Total Company	INTERSTATE	INTRASTATE
Total Operating Expenses	\$ 2,559,129	\$ 868,867	\$ 1,690,262
Depreciation & Amortization	1,029,292	415,777	613,515
Cash Operating Federal Income Taxes	91,815	108,541	(16,726)
Cash Operating State & Local Taxes	19,654	23,235	(3,580)
Total Cash Operating Expenses	\$ 1,641,307	\$ 584,866	\$ 1,056,441
% LAG (30 days)	8.33%	8.33%	8.33%
TOTAL CASH WORKING CAPITAL	\$ 136,721	\$ 48,719	\$ 88,002

Southwestern Telephone Company

Proposed Rate Design

June 30, 2013 TTM Average Units*

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Service Description	Average Units ^(a)	Current Rates	2011 Annual Revenues	Proposed Rates	Proposed Revenues	Proposed Change Revenue	Proposed Change Percent
Basic Service							
Residence One-Party	1,456	\$ 14.00	\$ 244,608	\$ 19.00	\$ 331,968	\$ 87,360	35.71%
Residence Two-Party	-	\$ -	\$ -	\$ 19.00	\$ -	\$ -	
Estimated Revenue from Local Rate Increase						\$ 87,360	

Notes:

*Average units are used to capture seasonal fluctuations.

(a) No reduction made for line loss.

Residential Lines

Year	Type	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	One-Party	2,916	2,982	2,964	2,492	1,759	1,556	1,481	1,443	1,449	1,609	2,179	2,498
2009	Two-Party	5	5	4	4	4	4	4	4	4	4	4	4
2009	Total	2,921	2,987	2,968	2,496	1,763	1,560	1,485	1,447	1,453	1,613	2,183	2,502
2010	One-Party	2,613	2,667	2,647	2,249	1,584	1,425	1,345	1,320	1,338	1,473	1,989	2,234
2010	Two-Party	4	4	4	4	4	4	4	4	4	2	2	2
2010	Total	2,617	2,671	2,651	2,253	1,588	1,429	1,349	1,324	1,342	1,475	1,991	2,236
2011	One-Party	2,317	2,376	2,343	2,033	1,501	1,324	1,242	1,225	1,223	1,339	1,752	1,984
2011	Two-Party	2	2	2	2	2	2	2	2	2	2	2	2
2011	Total	2,319	2,378	2,345	2,035	1,503	1,326	1,244	1,227	1,225	1,341	1,754	1,986
2012	One-Party	2,066	2,095	2,067	1,798	1,363	1,208	1,144	1,128	1,119	1,216	1,562	1,768
2012	Two-Party	2	2	2	2	2	2	2	2	2	2	2	2
2012	Total	2,068	2,097	2,069	1,800	1,365	1,210	1,146	1,130	1,121	1,218	1,564	1,770
2013	One-Party	1,823	1,884	1,854	1,600	1,248	1,125	-	-	-	-	-	-
2013	Two-Party	-	-	-	-	-	-	-	-	-	-	-	-
2013	Total	1,823	1,884	1,854	1,600	1,248	1,125	-	-	-	-	-	-



PUBLIC NOTICE

Exhibit A-2

Federal Communications Commission
445 12th St., S.W.
Washington, D.C. 20554

News Media Information 202 / 418-0500
Internet: <http://www.fcc.gov>
TTY: 1-888-835-5322

DA 14-384
Released March 20, 2014

**WIRELINE COMPETITION BUREAU ANNOUNCES RESULTS OF
URBAN RATE SURVEY FOR VOICE SERVICES;
SEEKS COMMENT ON PETITION FOR EXTENSION OF TIME
TO COMPLY WITH NEW RATE FLOOR**

WC Docket No. 10-90



Oppositions Date: March 21, 2014
Replies Date: March 31, 2014

Today, the Wireline Competition Bureau announces the results of the urban rate survey for fixed voice services, which will be used to determine the 2014 rate floor for incumbent eligible telecommunications carriers (ETCs) and the reasonable comparability benchmark for voice services.¹ We also seek comment on a petition to extend the deadline for compliance with the 2014 rate floor.

In the *USF/ICC Transformation Order*, the Commission adopted a rate floor “to ensure that states are contributing to support and advance universal service and that consumers are not contributing to the Fund to support customers whose rates are below a reasonable level.”² To be consistent with section 254(b) of the Communications Act, the Commission also determined that “ETCs must offer voice telephony service, including voice telephone service offered on a standalone basis, at rates that are reasonably comparable to urban rates,”³ and it adopted a presumption that “a voice rate is within a reasonable range if it falls within two standard deviations above the national average.”⁴ In the *USF/ICC Transformation Order*, the Commission directed the Wireline Competition Bureau and Wireless Telecommunications Bureau to conduct a survey of residential urban rates for, among other things, fixed voice and fixed broadband services.⁵

On April 3, 2013, the Wireline Competition Bureau (Bureau) and the Wireless Telecommunications Bureau adopted an order setting the form and content for a survey of urban rates for

¹ See *Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support; Developing a Unified Intercarrier Compensation Regime; Federal-State Joint Board on Universal Service; Lifeline and Link-Up; Universal Service Reform—Mobility Fund*; WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17694, 17751, paras. 84-85, 238 (2011) (*USF/ICC Transformation Order*), *pets. for review pending sub nom. In re: FCC 11-161*, No. 11-9900 (10th Cir. argued Nov. 19, 2013).

² *USF/ICC Transformation Order*, 26 FCC Rcd at 17751, para. 238 (emphasis and footnote omitted).

³ *Id.* at 17693, para. 81.

⁴ *Id.* at 17694, para. 84.

⁵ *Id.* at 17694, 17708, paras. 85, 114.

fixed voice and fixed broadband residential services, as required by the *USF/ICC Transformation Order*.⁶ On December 16, 2013, the Bureau initiated the survey and collected the rates offered by a statistically valid sample of facilities-based providers of fixed services identified using the most recent FCC Form 477 data in 500 urban Census tracts.⁷

Based on the survey results, the Bureau has calculated that the average local end-user rates plus state regulated fees of the surveyed ILECs in urban areas is \$20.46. The *USF/ICC Transformation Order* defined the average urban rate to include local end-user rates plus state regulated fees (specifically, state subscriber line charges (SLCs), state universal service, and mandatory extended area service charges).⁸ The Commission specifically did not include the federal SLC in the calculation for the rate floor. The Bureau found that non-ILEC provider recurring monthly rates collected in the survey typically were higher than ILEC reported recurring monthly rates. Non-ILEC providers who do not separately charge and report a federal SLC may charge recurring monthly rates similar to an ILEC's monthly charge plus the federal SLC. The Bureau calculated the average using urban ILEC rates from the sample in order to avoid inclusion of rates that may be designed to match the ILEC's monthly local rate plus the federal SLC.

Based on the survey responses, the Bureau also calculated the reasonable comparability benchmark for voice services to be \$46.96.⁹ For purposes of the reasonable comparability benchmark, the Bureau concluded that the rates of all local flat-rate providers (both ILEC and non-ILEC providers) and, consistent with existing precedent, federal SLCs, should be included.¹⁰ The purpose of the reasonable comparability measurement is to ensure that rural rates do not significantly exceed urban rates. From the consumer's perspective, it is the total local rate (the base charge plus the federal SLC) that is relevant. Therefore, establishing a benchmark based on the price of local voice services offered by all voice providers in urban areas is the most reasonable basis for comparison.

Under the Commission's rules, by July 1, 2014, all ETCs that are ILEC recipients of high-cost support must report the number of residential service lines for which the sum of the rate and state fees are below \$20.46 as of June 1, 2014.¹¹ In addition, each ETC, including competitive ETCs, must certify that the pricing of the voice services is no more than \$46.96.¹²

On March 11, 2014, the Eastern Rural Telecom Association (ERTA), the Independent Telephone & Telecommunications Alliance (ITTA), NTCA, the National Exchange Carrier Association (NECA), the

⁶ *Connect America Fund*, WC Docket No. 10-90, Order, 28 FCC Rcd 4242 (Wireline Comp. Bur. and Wireless Telecom. Bur. 2013).

⁷ *Wireline Competition Bureau Announces Timeline for Completion of Urban Rates Survey*, WC Docket No. 10-90, Public Notice, 28 FCC Rcd 16753 (Wireline Comp. Bur. 2013). The sample included fixed, facilities-based, terrestrial (not mobile) voice providers, including incumbent local exchange carriers (ILECs), cable companies, and fixed wireless providers.

⁸ *USF/ICC Transformation Order*, 26 FCC Rcd at 17751, para. 238.

⁹ *Id.* at 17694, para. 84.

¹⁰ *Id.*

¹¹ 47 C.F.R. § 54.313(h). To the extent that an ILEC's local rates (plus state regulated fees) are less than the urban rate floor, that carrier's high-cost support will be reduced on a dollar-for-dollar basis. This applies both to price cap and rate-of-return carriers, and to high-cost loop support as well as Connect America Fund Phase I frozen support. See *USF/ICC Transformation Order*, 26 FCC Rcd at 17751-52, para. 239.

¹² 47 C.F.R. § 54.313(a)(10).

United States Telecom Association (USTelecom), and WTA – Advocates for Rural Broadband filed a joint petition requesting that the deadline for compliance with the 2014 local service rate floor be extended from July 1, 2014 to January 2, 2015, and that subsequent adjustments to the rate floor should then be made annually on January 2.¹³ Pursuant to section 1.45 of the Commission's rules, oppositions to the petition are due on March 21, 2014, and replies would be due on March 26, 2014. Pursuant to section 1.3 of the Commission's rules,¹⁴ however, we waive the provisions in section 1.45(c) of the Commission's rules relating to the replies filing deadline and the substantive content of replies, to extend the reply period to March 31, 2014 in order to allow more time for parties to comment on the petition, as well as any alternative approaches that would protect consumers while ensuring swift implementation of the Commission's statutory obligation to ensure reasonably comparable rates. For example, we seek comment on a longer phase-in of the rate floor than the extension requested by petitioners.

Pursuant to sections 1.45, 1.47-1.49, and 1.51-1.52 of the Commission's rules,¹⁵ interested parties may file **oppositions to the petition on or before March 21, 2014 and replies on or before March 31, 2014**. All pleadings are to reference **WC Docket No. 10-90**. Pleadings may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.¹⁶

- *Electronic Filers:* Pleadings may be filed electronically using the Internet by accessing the ECFS: <http://fjallfoss.fcc.gov/ecfs2/>.
- *Paper Filers:* Parties who choose to file by paper must file an original and one copy of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail. All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.
 - All hand-delivered or messenger-delivered paper filings for the Commission's Secretary must be delivered to FCC Headquarters at 445 12th St., SW, Room TW-A325, Washington, DC 20554. The filing hours are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes and boxes must be disposed of before entering the building.
 - Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.
 - U.S. Postal Service first-class, Express, and Priority mail must be addressed to 445 12th Street, SW, Washington, DC 20554.
- *People with Disabilities:* To request materials in accessible formats for people with disabilities (braille, large print, electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice), 202-418-0432 (tty).

Additional Copies. In addition, we request that you send one copy of each pleading to each of the following:

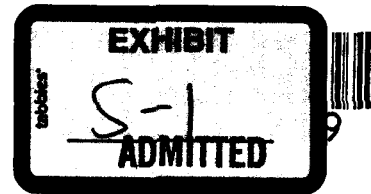
¹³ Petition for Extension of Time by ERTA, ITTA, NECA, NTCA, USTelecom and WTA, WC Docket No. 10-90 (filed Mar. 11, 2014).

¹⁴ 47 C.F.R. § 1.3.

¹⁵ 47 C.F.R. §§ 1.45, 1.47-1.49, 1.51-52.

¹⁶ See *Electronic Filing of Documents in Rulemaking Proceedings*, 63 FR 24121 (1999).

**MEMORANDUM
RECEIVED**



TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

2014 MAR 21 P 12:20

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

Date: March 21, 2014

ORIGINAL

RE: IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN
TELEPHONE COMPANY FOR A HEARING TO DETERMINE THE
EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY
FOR RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL
RATES AS NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF
THE FCC'S USF/ICC TRANSFORMATION ORDER. (DOCKET NO. T-
01072A-13-0412)

Attached is the Staff Report for Southwestern Telephone Company's Application to increase residential rates to compensate for the rate impacts of the Federal Communications Commission's Universal Service Fund/Intercarrier Compensation ("FCC's USF/ICC") Transformation Order.

Staff recommends approval of Southwestern Telephone Company's request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC.

SMO:PJG:red\CHH

Originator: Pamela J. Genung

Attachment: Original and Thirteen copies

Arizona Corporation Commission
DOCKETED

MAR 21 2014

DOCKETED BY	
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SERVICE LIST FOR: SOUTHWESTERN TELEPHONE COMPANY
DOCKET NO. T-01072A-13-0412

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STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

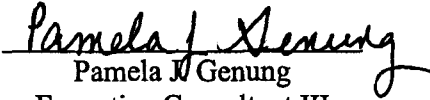
SOUTHWESTERN TELEPHONE COMPANY
DOCKET NO. T-01072A-13-0412

IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN TELEPHONE
COMPANY FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY,
THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO
INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE
IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER

MARCH 21, 2014

STAFF ACKNOWLEDGMENT

The Staff Report for Southwestern Telephone Company, Docket No. T-01072A-13-0412, was prepared by the Staff member shown below.


Pamela J Genung
Executive Consultant III

**EXECUTIVE SUMMARY
SOUTHWESTERN TELEPHONE COMPANY
DOCKET NO. T-01072A-13-0412**

On November 27, 2013, Southwestern Telephone Company ("Southwestern Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased as necessary to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, USF/ICC Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250.

Staff recommends that the Southwestern Telephone monthly residential local exchange rate increase from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to Southwestern Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increases; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff further recommends that any future rate increase applications filed by Southwestern Telephone be processed per full A.A.C. R14-2-103 requirements, not streamlined.

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INTRODUCTION

On November 27, 2013, Southwestern Telephone Company ("Southwestern Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased as necessary to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, USF/ICC Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250. A.A.C. R14-2-103(A)(1) requires specific financial and statistical information be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return earned. Southwestern Telephone submitted a streamlined filing containing the following five exhibits to support the requested increase in residential rates:

- Regulated Results of Operations Twelve Months Ending June 30, 2013
- Rate Base as of June 30, 2013
- Cash Working Capital
- Proposed Rate Design
- Year 2 Estimated ICC Impact of FCC Order

On December 17, 2013, the Applicant filed a Time Clock Waiver for thirty (30) days.

On January 29, 2014, the Applicant filed a Supplemental Filing.

BACKGROUND

Southwestern Telephone is a corporation duly organized and existing under and by virtue of the laws of the State of Arizona. Southwestern Telephone is authorized to engage in and is now engaged in the conduct of a general communications business within the State of Arizona. Southwestern Telephone is a small rate-of-return ("RoR") regulated incumbent local exchange carrier ("ILEC").

On November 18, 2011, the FCC issued the USF/ICC Order. The USF/ICC Order transitions the outdated federal universal service programs and most intercarrier compensation systems into a new Connect America Fund ("CAF"). The FCC's press release characterized the USF/ICC Order as "the most significant policy step ever taken to connect all Americans to broadband."

In its USF/ICC Order, the FCC stated that it will reduce intercarrier compensation rates to zero by July 1, 2020, for RoR companies, with limited recovery from customers and partial recovery from the CAF. The recovery from the CAF will phase out over time at 5 percent annually. The USF/ICC Order adds new rules that will reduce federal high-cost loop support ("FHCLS") to carriers by the amount their flat-rate residential local service rates fall below a specified annual rate floor. The rate floor includes state subscriber line charges, state universal service fees, and mandatory extended area service charges, if any are assessed. The FCC's order establishes single line residential local service rate floors of \$10.00 as of June 1, 2012, \$14.00 as

of June 1, 2013, with the floor thereafter being determined annually by the FCC's Wireline Competition Bureau, based on a nationwide average. To date, the Wireline Competition Bureau has not determined the rate floor to be in effect for June 1, 2014. The FCC is conducting a survey of urban rates for fixed voice residential services, required by the USF/ICC Order. The information collected in this survey will be used to establish a rate floor for voice services that eligible telecommunications carriers ("ETCs") receiving high cost loop support ("HCLS") or frozen high-cost support must meet in order to receive their full support amounts.

To maintain FHCLS, Southwestern Telephone and other rural ILECs must increase single line residential local rates to the FCC-mandated residential rate floors. Otherwise, the amount of FHCLS funds will be reduced dollar-for-dollar for each customer by the difference between the existing single line local rate and the new rate floor.

The Arizona Corporation Commission's ("Commission") last considered Southwestern Telephone's rates in Docket No. T-01072A-12-0472, which resulted in Commission Decision No. 73874¹, dated May 8, 2013. With this application, Southwestern Telephone seeks Commission approval to raise its residential local service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC.

CONSUMER SERVICES

On December 18, 2013, the Records Section of the Corporations Division responded that Southwestern Telephone is in Good Standing. A review of the Consumer Services database revealed that no complaints, inquiries and opinions were received pertaining to Southwestern Telephone for the period January 1, 2010 through December 20, 2013.

PUBLIC NOTICE

On February 28, 2014, Southwestern Telephone filed a Proof of Mailing indicating that the required notice was provided to Southwestern Telephone's Arizona customers in the format prescribed in the Procedural Order dated January 24, 2014.

COMPLIANCE

A check of the Utilities Division Compliance Section database showed that Southwestern Telephone is in Compliance with all items.

¹ Decision No. 73874 authorized Southwestern Telephone to raise its residential one-party rates to \$14.00/month, effective June 1, 2013.

OPERATING INCOME STATEMENT

Southwestern Telephone submitted Regulated Results of Operations for Twelve Months Ending June 30, 2013 in its streamlined filing. The submitted information was accepted without adjustment for the purposes of this streamlined Application.

Operating Revenue and Expenses

According to the information provided by the Applicant, Southwestern Telephone Total Intrastate

Operating Revenues for the Twelve Months Ending June 30, 2013 were \$1,638,894. Subcategories of Total Intrastate Operating Revenues are noted below:

Local	\$695,034
Universal Service Fund (USF-HCL)	\$385,743
Access Revenues	\$490,375
Billing & Collecting	\$ 17,583
Other Misc., Uncollectibles	\$ 50,159

The Applicant also stated that its Total Intrastate Operating Expenses for the Twelve Months Ending June 30, 2013 were \$1,690,262. Subcategories of Total Intrastate Operating Expenses are noted below:

Plant Specific Operations	\$365,039
Plant Non-specific Operations	\$129,505
Depreciation & Amortization Exp.	\$613,515
Customer Operations Expenses	\$210,290
Corporate Operations Expenses	\$277,502
Other Operating Taxes and (Income)	\$ 94,411

Operating Income

As provided by the Applicant, Southwestern Telephone's Total Intrastate Operating Income for the Twelve Months Ending June 30, 2013 was negative \$51,368 before taxes and negative \$31,062 after taxes.

RATE BASE

According to Southwestern Telephone, the interstate and intrastate rate base is \$3,504,514, as stated in the table below:

Southwestern Telephone Company
Rate Base as of June 30, 2013

	Total Company	Interstate	Intrastate
Plant In Service	\$ 18,462,869	\$ 7,892,320	\$10,570,549
<i>Accumulated Depreciation</i>	<u>(14,544,450)</u>	<u>(6,324,721)</u>	<u>(8,219,729)</u>
Net Plant in Service	\$ 3,918,419	\$ 1,567,599	\$ 2,350,820
Plant Under Construction	20,587	8,757	11,830
Material & Supplies	118,826	34,484	84,342
Deferred Income Taxes	(690,039)	(293,463)	(396,576)
Cash Working Capital	<u>136,721</u>	<u>48,719</u>	<u>88,002</u>
Rate Base	\$ 3,504,514	\$ 1,366,096	\$ 2,138,418

CUSTOMER BASE

Southwestern Telephone reported 1,770 residential lines and 879 business lines in its Utilities Annual Report received April 15, 2013.

REVENUE REQUIREMENT

As stated above, the Applicant's filing was based on streamlined requirements to meet the FCC's deadline for federal USF funding. Therefore, the Applicant's filing does not contemplate rate adjustments based on a typical revenue requirement analysis.

RATE DESIGN

The Applicant is seeking to increase its residential local exchange service rate up to \$19.00. The actual rate implemented would be set at the lesser of the approved 2014 local service rate floor or \$19.00. Southwestern Telephone indicated that it will file the new FCC rate floor as soon as it is available. The Applicant's filing only contemplates changes to residential local exchange rates to compensate for the rate impacts of the FCC's USF/ICC order. With this filing, Staff will only address the monthly increase of all residential local exchange service rates from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC.

STAFF ANALYSIS

Staff did not perform a regulatory audit of the information submitted by Southwestern Telephone. However, Staff reviewed the information filed in the context of the FCC's November 18, 2011 USF/ICC Order, which is intended to transition the outdated federal universal service programs and most intercarrier compensation systems into a new CAF.

Staff has analyzed this application in terms of whether there were fair value implications. For the purposes of this matter, the Applicant stipulated to the use of original cost less depreciation as the basis for a determination of its fair value rate base ("FVRB"). The Applicant states that its intrastate rate base is \$2,138,418. The Applicant provided information that indicates that its Total Intrastate Operating Revenue for the Twelve Months Ending June 30, 2013 was \$1,638,894.

According to the Applicant, the annual revenue effect of the increase in residential local telephone service rates to \$19.00 is \$87,360.² Southwestern Telephone's return on rate base would increase from being negative to 1.0 percent. In the Applicant's Supplemental Filing, Southwestern Telephone indicated that the annual revenue effect of the increase in residential local telephone service rates to \$17.50 is \$61,152.³ At the \$17.50 residential local service rate, Southwestern Telephone's Return on Rate Base would be 0.3 percent, versus 1.0 percent if the residential rate floor is set at \$19.00 per month. Compared to the Applicant's total revenues, any revenue impact from this rate increase would be small and any impact on the Applicant's FVRB would be de minimus.

STAFF'S RECOMMENDATIONS

Staff recommends approval of Southwestern Telephone's request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC.⁴ Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to Southwestern Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increases; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff further recommends that any future rate increase applications filed by Southwestern Telephone be processed per full A.A.C. R14-2-103 requirements, not streamlined.

Staff has reviewed the rate application and the federal rule changes that have prompted the rate application. Staff concludes that the costs appear reasonable and appropriate under the unique circumstances of this case. However, Staff's recommendation in these unique

² Based on 1,456 one-party residential lines.

³ Based on 1,456 one-party residential lines.

⁴ The rate floor compliance date is the date (currently June 1) on which the local service rate must equal or exceed the FCC rate floor so a company receiving federal high-cost loop support may continue to receive all of its authorized Federal Universal Service Fund revenues.

Southwestern Telephone Company
Docket No. T-01072A-13-0412
Page 6

circumstances should not be viewed as precedent for the processing of future rate case applications.